COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

FITCHBURG GAS & ELECTRIC LIGHT COMPANY	)	**D.T.E. 02-24/25**

REPLY BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,

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I. INTRODUCTION

The Attorney General submits this Reply Brief to the Department of Telecommunications and Energy ("Department") in response to the initial briefs of Fitchburg Gas and Electric Light Company ("Fitchburg" or the "Company") and the Division of Energy Resources ("DOER").[1]

Fitchburg continues to present "moving targets" for its two rate cases, attempting to change the record and even to propose new adjustments, going far beyond the normal updates on fully-litigated issues (such as property tax bills or updated inflation indices). With such proposed changes, the Company has increased the total rate hike sought for its electric and gas divisions from $6.6 million to over $6.9 million, exceeding the publicly noticed amounts. These extra-record submissions, set forth without any motion to reopen the record, violate Department regulations and precedent and prejudice the rights of other parties. 220 CMR 1.11(8); *Boston Gas Company*, D.P.U. 88-67 (Phase 2), p.7 (1989). The Company thus continues an unfortunate pattern. In Fitchburg's last request for a general rate increase, the Department criticized as "maladroit at best" the Company's attempt to add to rate base on the final days of hearings through a record response on an unrelated issue. The Department denied the request, noting that there was "no opportunity to conduct discovery on this proposed addition or to cross examine the Company . . . ." *Fitchburg Gas and Electric Light Company*, D.T.E. 98-51, p. 9 (1998). The

[1] The Attorney General files this Reply Brief for the limited purpose of responding to certain positions taken in the Initial Briefs filed by other parties in this proceeding. This Reply Brief is not intended to respond to every argument made or position taken. Rather, it is intended to respond only to the extent necessary to assist the Department's deliberations, *i.e.,* to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence in regard to any particular argument, assertions of fact, or statement of position in the various Initial Briefs should not be interpreted, construed, or treated as assent, acquiescence or agreement with such argument, assertion or position.

Department should grant the Attorney General's accompanying Motion To Strike and impose appropriately/meaningful sanctions against the Company to deter these repeated, wilful violations of Department rules that unfairly prejudice the rights of other parties.

The Department, for the reasons set forth in the Attorney General's briefs, should reject the Company's proposed new rates and tariffs and adopt all of the Attorney General's pro forma adjustments. As is customary in this type of proceeding, the Attorney General has provided his final recommendations concerning the Company's revenue requirements in schedules attached to this brief.

II. RATE BASE

A. THE DEPARTMENT SHOULD CREDIT THE PRINCETON PAPER EQUIPMENT DEPOSIT AGAINST RATE BASE

The Attorney General explained that the Department should credit $893,495 in equipment deposits related to the Energy Bank contract for electric service to Princeton Paper ("Princeton") against rate base. AG IBr., pp. 6-7. Princeton advanced these funds to secure plant additions that are currently in rate base and that Fitchburg is recovering from other customers through rates. *Id*. The Company responds that it should retain these deposits because the bankruptcy court allowed the Company to retain these deposits as an offset to gas and electric charges, as well as for legal fees related to the bankruptcy.[2] FGE IBr., pp. 16-17. The Company also argues that its actions in the Bankruptcy court benefitted customers by preventing a write-

[2] Although the Company argues that, under the Energy Bank contract, it was supposed to return the $893,495 to Princeton under certain conditions (FGE IBr., p. 17), as a factual matter those conditions were never met and never legally enforceable because Fitchburg had not returned or otherwise credited the equipment deposit to Princeton at the time of the bankruptcy. *See* Exh. AG-1 (Energy Bank contract, §§ 5.1-5.4)

off for its gas and electric customers. *Id*. Finally, the Company attempts to rehabilitate its cost of service witness, Mark Collin, regarding his failure to disclose the details of the Princeton bankruptcy when the Attorney General directly questioned him on this topic by the Attorney General in DTE 99-118. FGE IBr., p. 16, n. 7.[3]

The actions of the bankruptcy court do not bind the Department for ratemaking purposes, especially in these circumstances where the utility itself did not file for bankruptcy and

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[3] The bankruptcy settlement had already been negotiated and approved by the time of the May and June 2001 hearings in DTE 99-118. Exh. AG-1 (Settlement approval, November 22, 2000). The Company's log of internal correspondence reveals that Princeton had been extensively discussed among employees, including the witness. AG-RR-1(c). It is also difficult to imagine that the Company's treasurer would not be aware of a multi-million dollar settlement involving demand charges stemming from a $6 million proof of claim he signed. Exh-AG-1 and 2 (proof of claim and amended proof of claim). Nonetheless, the Company did not reveal the settlement of the Energy Bank contract:

> Q: At some point in time did Fitchburg receive some type of order from the bankruptcy judge or the trustee regarding the obligations of Princeton Paper under that contract?
>
> A: Let me tell you what I'm aware of. As a utility, typically in bankruptcy the judge will order that the utility continue to provide service to the bankrupt customer, and under that order, the payments to the utility take first priority. So the utility continues to provide service to the bankrupt customer, and the bankrupt customer continues to pay the utility for that service under a special provision of the bankruptcy law that allows that relationship to continue. That's in contrast to other vendors, who may just elect to discontinue providing service to a customer because they are bankrupt. As a utility, we don't have that option.
>
> Q: I guess my question is a little more specific. Did the Bankruptcy Court change any of the provisions of the contract – specifically the demand charge? Did they reduce your demand charge or eliminate it?
>
> A: No.

DTE 99-118, Tr. 2, pp. 297-298 (incorporated by reference). Certainly, the Company's witness was "aware" of far more detail than he testified to in response to the first question. By the time of the testimony, the Bankruptcy Judge had already issued the settlement "order." Furthermore, by approving a $3 million settlement of the $6 million claim involving demand charges, the bankruptcy court did, in fact, "reduce or eliminate" demand charges. The witness testified otherwise. The Department, therefore, should consider the witness's lack of candor in evaluating all of his testimony in this case.

the bankruptcy court did not address the issue of the ratemaking consequences of its approval of the settlement with the Company. *See Western Massachusetts Electric Company*, D.P.U. 85-270, pp. 118-119 (1986) (accounting standards do not supercede Department's duty to set just and reasonable rates). The Company admitted on cross examination that it never sought Department approval of the proposed settlement, and that the actions of the bankruptcy court do not dictate ratemaking treatment. Tr. 11, pp. 1312-1314. The Company's proposed method is unfair to customers since they are already paying for the plant additions in rates. Furthermore, by keeping the equipment deposit for itself, the Company seeks to recover a pre-test year write-off, but has not proved that its bad debt expense calculation excludes the figures from Princeton. The Department should reject the Company's unfair method and credit the Princeton Equipment deposit as a reduction to rate base.

B. THE OLD SAWYER PASSWAY SUBSTATION IS NO LONGER USED AND USEFUL IN SERVING CUSTOMERS AND THE DEPARTMENT SHOULD ORDER THAT IT BE REMOVED FROM RATE BASE.

The Company argues that it should be allowed to include in rate base both the new $5.2 million Sawyer Passway Substation and the old substation that it replaced, with a net plant balance of $395,000 and related depreciation expenses. FGE IBr., pp. 19-23; Tr. 12, pp. 1420. Fitchburg unsuccessfully attempts to argue that the Attorney General has misconstrued regulatory precedent on "used and useful" plant, asserting that the Department only removes plant from rate base under "extraordinary circumstances" and only makes post-test year rate base adjustments that are "unusual in nature and extraordinary in amount." FGE IBr., pp. 19-23.

Fitchburg, not the Attorney General, has misconstrued Department "used and useful" plant precedent. The Company fails to recognize that the Department no longer considers whether the plant change is unusual in nature. FGE IBr., pp. 19-23; *Nantucket Electric*

Company, D.P.U. 91-106/138, p. 90 (1983), citing *Western Massachusetts Electric Company*, D.P.U. 1300, p. 18 (1983).[4] The Company, moreover, failed to address the most applicable Department precedents regarding what circumstances are "extraordinary." The Department has found that the replacement of old plant with large new plant additions is the kind of extraordinary circumstance where a post-test year adjustment is appropriate, even when the replacement is not expected to be completed until well after the end of the test year. *Western Massachusetts Electric Company*, D.P.U. 85-270, pp. 140-141 (1985) (Department removed three fossil-fuel generating units from rate base where those units would no longer be useful because of the addition of Millstone 3). Similarly, the Department recently found extraordinary circumstances and removed from rate base redundant plant that was not in service providing benefits to customers and was slated for sale. *Berkshire Gas Company*, D.T.E. 01-56, pp. 42-43 (2002). The Department has explained that its reluctance to make post-test year plant additions relates in part to the need to balance plant additions and retirements:

> [o]rdinary plant additions occurring after the end of the test year are excluded from rate base, in part because, while normal additions may be easily identified, offsetting periodic retirements from plant in use are not. Therefore, the Department, viewing these changes as balancing one another, has tended to adhere to the rate base structure as it occurred during the test year.

Edgartown Water Company, D.P.U. 62, p. 3 (1980).

In this case, the Company stated that the new plant was "fully operational" by the middle of the test year and the old substation that it replaced ceased operation permanently only three

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[4] The result in those two Department cases turned, at least in part, on whether the new plant represented a sizable investment and was "significant" in relation to total rate base. The inquiry is somewhat different where, as here, the issue is removal from rate base of plant that is being replaced by new plant additions and is therefore no longer used and useful. Fitchburg's citation to *NYNEX*, D.P.U. 94-50, p. 298 (1995)(FGE IBr., pp. 20) concerned plant that the Department found to be used and useful and so is inapposite.

weeks after the end of the test year. AG-RR-52 (E). Where plant becomes redundant and permanently ceases operation shortly after the end of the test year as a result of replacement by a major capital addition, there are "extraordinary circumstances" that justify a post-test year removal from rate base.[5] Accordingly, the Department should remove from the cost of service the net plant balance of $394,693 and depreciation expense of $61,516 relating to the old Sawyer Passway Substation. *Id*.[6]

C. THE DEPARTMENT SHOULD ORDER THE COMPANY TO DEDUCT CUSTOMER SUPPLIED COST-FREE CAPITAL FROM RATE BASE.

The Company argues that "contribution in aid of construction" funds that total $176,123 for the electric division and $269,185 for the gas division should be excluded, not deducted, from rate base. Co. IBr., pp. 40-41. Under Department precedent, it is clear that these amounts should be deducted from the Company's rate base.

The Company appears to be confused about the application of the terms "exclude" and "deduct". Although the Company cites two cases as support for its claim that contribution in aid of construction funds should be excluded and not deducted, in fact its reliance on those two cases is misplaced, and the two cases actually refute the Company's claim. Co. IBr. pp. 40-41;

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[5] Removal of costs of the old substation would be even more important if the Department adopts the proposed ten-year performance-based ratemaking ("PBR") plan. It is "inappropriate" to include in the calculation of representative rates plant that is no longer in service or providing benefits to ratepayers and that is slated for sale. *Berkshire Gas Company*, D.T.E. 01-56, p. 43 (2002).

[6] Fitchburg violates Department regulations and precedent by attempting, in its brief without a motion, to change and supplement the record regarding the old Sawyer Passway Substation depreciation expense and estimated removal costs. FGE IBr, pp. 19-22, n. 9, 10,11; *Boston Gas Company*, D.P.U. 88-67 (Phase 2), p.7 (1989) ("the procedural impropriety of thrusting extra-record facts upon the trier of fact deserves comment. The familiar analogy that one cannot unring a bell is apt in these circumstances.") The Department should grant the Attorney General's Motion To Strike the Company's extra-record comments and submissions and do its best to ignore the "ringing in its ears" caused by Fitchburg's violations. *Boston Gas Company, supra*.

Hingham Water Co., D.P.U. 1590 at 10-11 (1984); *Berkshire Gas Co.*, D.P.U. 90-121 at 74 (1991). In *Hingham Water Co.*, the Department stated that "the balance of construction advances on the books of the Company at the end of the test year is the appropriate and representative amount to use as a **reduction** to rate base for ratemaking purposes...[and the] test year-end balance of construction advances will be **deducted** from rate base." *Hingham Water Co.*, D.P.U. 1590 at 10-11 (1984)(emphasis added). The Department similarly subtracted "contribution in aid of construction funds" from rate base in *Berkshire Gas Co.*, D.P.U. 90-121 at 74 (1991) citing *Hingham Water Co.* as its precedent. In other words, the proper treatment for "contribution in aid of construction" funds is to **subtract** it from rate base so that it is a **reduction** to rate base. Accordingly, the Department should direct the Company to subtract $176,123 for its electric division and $269,185 for its gas division from rate base.

The Company does not dispute the Attorney General's contention that the "unclaimed funds" balance should be subtracted from the Company's rate base, and the Department should direct the Company to subtract this figure from rate base. *Western Massachusetts Electric Company*, D.P.U. 85-270, p. 139-140 (1986); *Boston Edison Company*, D.P.U. 1350, p. 32 (1983).

D. THE COMPANY OVERSTATES ITS CASH WORKING CAPITAL NEEDS

1. OTHER O&M EXPENSES

The Department has twice previously ordered the Company to propose an alternative to using the outmoded 45-day convention for determining working capital on the Company's Other O&M expenses. *Fitchburg Gas and Electric Light Company*, D.T.E. 98-51, p. 16 (1998); *Fitchburg Gas and Electric Light Company*, D.T.E. 99-118, p. 30, n. 23 (2001). In the latter case, the Department ordered Fitchburg to "conduct a lead-lag study or undertake a reasonable, cost effective alternative to a lead-lag study in order to address the continued validity of the 45-day convention in Fitchburg's case or to propose a different interval." *Fitchburg Gas and Electric Light Company*, D.T.E. 99-118, p. 30, n. 23 (2001).

The Company, asserting that it has complied with the Department's directives, states that it issued RFPs, received two bids, and conducted a cost/benefit analysis to determine whether it would be more beneficial and cost-effective to conduct a lead/lag study or retain the 45-day convention, before it opted to retain the 45-day convention. Co. IBr., pp. 32-36. The Company, however, did not follow the Department's clear order to address, either by a study or an alternative to a study, the validity of the 45-day convention. The Company simply purports to show that a lead-lag study would not be cost effective, which does not satisfy the Department's directive.

Even this limited analysis, however, is fatally flawed since it unreasonably favored the higher ($193,000) bid and did not equally consider the lower ($60,000) bid. Tr. 3, pp. 371-372; Tr. 13, p. 1638.[7] Moreover, the Company testified that by its analysis, the lower bid showed a 63% probability of benefits exceeding costs. Tr. 13, p.1638; *see also* DTE-RR-12; DTE-RR-64. The 63% figure would be even greater if the Company did its cost/benefit calculation over a 10-year period as proposed in its PBR plan instead of the current 7-year period.[8] The record evidence thus shows that conducting a lead/lag study is likely to be more beneficial to customers

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[7] The Company's statements that the low bidder was "independent"and "no longer with a large firm" and was "going to provide that service probably out of their house" does not show that the low bidder was not qualified to conduct the survey. *See* Tr. 3, pp. 371; Tr. 13, p. 1638.

[8] Even for the higher bidder, the probability of benefits exceeding costs would increase above 50% if the Company conducted its cost/benefit analysis over 10 years rather than 7 years.

than retaining the 45-day convention. Given the Department's clear directive, the small size of the Company, and the straightforward nature of a working capital analysis, Fitchburg should have done more to comply with the Department's order.

The Department should deny the Company recovery of cash working capital for Other O&M expenses because the Company failed to follow the Department's order and failed to show the need for any cash working capital for Other O&M expenses.

2. THE DEPARTMENT SHOULD ELIMINATE CERTAIN REVENUE LAG COMPONENTS PROPOSED BY THE COMPANY

The Attorney General explained that the Company's proposed 2.43 day meter to billing lag and two day funds collection to receipt lag should both be zero lag days if the Company is going to use the Accounts Receivable methodology for determining the collection lag. The meter read download, the bill generation and the accounts receivable recognition can all occur on the same day. AG IBr., pp. 13,15. Since the collection lag begins when the Account Receivable is recorded, and the meter reading information can be instantaneously converted into bills, there is no billing lag. The Company responds that the Attorney General's explanation "is an erroneous assumption contrary to good cash management and modern banking practices", is "oblivious to the realities of the actual work involved," and "simply without logic or reason." Co. IBr., pp. 35-36.

Contrary to the Company's claims, the Attorney General is not suggesting that all these activities **should** take place on the same day. Co. IBr., p 35. Rather, the Attorney General has shown and the record evidence supports that all these activities **can** or indeed do occur on the same day. The Company has not refuted that record evidence. Even though the Company may desire more time or may take more time, that preference is irrelevant since it is the accounts receivable recognition that determines the end of the billing lag. The Company chose the accounts receivable methodology for determining its collection lag. Therefore, it must use the accounts receivable methodology to determine its billing lag.

The Attorney General explanation on the funds collection to receipt lag issue is based on the Department's precedent not to adopt adjustments, for either a company or its ratepayers, for any alleged lags while checks clear. *Commonwealth Electric Company*, D.P.U. 90-331, p. 22 (1991). The Company has not addressed this precedent or cited any precedent or evidence sufficient to sustain its position.

The Department, therefore, should direct the Company to use a lag period of zero days for its meter to billing lag as well as its funds collection to receipt lag.

III. REVENUES

A. THE DEPARTMENT SHOULD ADJUST FOR INCREASED POST-TEST YEAR REVENUES OF NEWARK AMERICA.

The Department makes adjustments to achieve a representative level of revenues where the addition or deletion of a customer or change in customer sales, either during or after the test year, represents a known and measurable change to test year revenues, and constitutes a significant adjustment outside of the normal "ebb and flow" of customers. *Fitchburg Gas & Electric Light Company*, DTE 99-118, pp.16-20 (2001); *Massachusetts-American Water Company*, D.P.U. 88-172, pp. 7-9 (1989); *Western Massachusetts Electric Company*, D.P.U. 558, pp. 70-72 (1981).

The Company denies that an adjustment is justified for increased post-test year revenues provided by Newark America Company ("Newark"), even though the Department ordered a similar adjustment in the Company's last case for the post-test year loss of revenues of Princeton, which preceded Newark at the same site.[9] FGE IBr., pp. 42-44. Fitchburg attempts to distinguish the Princeton adjustment by claiming that: 1) Princeton's revenues were known and measurable--nearly all were derived from demand charges under two special contracts--whereas Newark has "an uneven load history and an announced intention to explore self-generation"; 2) Princeton's revenues represented an extraordinary proportion of FG&E's revenues; 3) the Department found Princeton's load to be "significant to any reasonable observer"; and 4) Princeton declared bankruptcy and ceased operations entirely before the rate year in the Company's last case, whereas Newark continues to be a customer. *Id.*

Notwithstanding Fitchburg's claims, (FGE IBr., p. 44) Newark's higher recent revenue levels are known and measurable, not "speculative." Newark's revenue levels are derived from actual billings during the four most recent months. RR-AG-58, p. 3. The record also refutes reflects the assertion that the recent usage is "uneven" and therefore unknown as Fitchburg implies.[10] During the first four months of 2002, consistent with Newark's business plans, Newark's revenues levels rose, as it increased its usage far above test year levels. Exh. AG-7-53(E), Atta. p. 1. During the most recent four months, however, Newark's revenues and demands have reached a plateau, declining only a small amount during the last four months.

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[9] Indeed, the Department found that "the loss of Princeton and the gain of Newark are sufficiently related that we cannot accept the one and exclude the other." *Fitchburg Gas & Electric Light Company*, DTE 99-118, p.19 (2001).

[10] Contrary to Fitchburg's implication, it is not necessary that a customer be leaving the system, as Princeton did, in order to make a revenue adjustment. *Massachusetts-American Water Company*, 88-172, p. 8 (1986). Nor is it necessary to have special contracts with high demand charge revenues in order for revenue levels to be known and measurable. Newark's usage characteristics are typical of established large customers. To restrict revenue adjustments only to customers whose revenue comes almost entirely from demand charges, as Fitchburg seems to urge, would contravene Department precedent and eliminate legitimate post-test year revenue adjustments.

RR-AG-58, p.3; RR-AG-3. The Company expects Newark's electric load and usage to continue at those recent levels for the next twelve months.[11] RR-AG-58, pp. 1-2.

The Department primarily considers whether there has been a post-test year customer change that is beyond the normal ebb and flow of customers. Newark's revenues and loads may not be not quite as large as Princeton's, but they still constitute a large proportion of Company totals and are "significant to any reasonable observer." *Fitchburg Gas & Electric Light Company*, DTE 99-118, p.18 (2001). The nearly fifteen-fold increase in Newark's load from the test year average to the most recent four months and the corresponding increase in Newark's electric revenues clearly show a significant change that renders the test year level unrepresentative. Exh. AG-7-53(E); RR-AG-3(confidential); RR-AG-58, p. 3(confidential). The Department should order a post-test year revenue adjustment of $640,622 based on the increase to the test year from the most recent available annualized revenues, from May through August, 2002.[12] RR-AG-3; RR-AG-58, p.3; Attachment 1 Confidential (showing the May-August 2002 revenues).

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[11] The mere possibility that Newark may engage in partial self-generation at some time in the future is no basis for disallowing an adjustment that is based on actual recent billings. *Fitchburg Gas & Electric Light Company*, DTE 99-118, p.18 (2001) (reliance on projected future events does not provide a sufficient basis for adjustment for proposed water treatment plant); *Milford Water Company*, 92-101, p. 26 (1993) (no adjustment for large customer addition that has not yet occurred).

[12] In order to calculate an appropriate revenue adjustment, the usage for the most recent three months was annualized. The test year level was subtracted from this annual level of kWh and KV usage to determine the incremental usage. Exh. AG-7-53. The incremental kWh usage was allocated to the peak and off peak based on the most recent actual usage pattern (56% peak usage). AG-RR-58. The incremental peak and off peak energy and the KV levels were priced at the test year rates and summed to yield the test year incremental revenue adjustment of $640,622. Attachment 1 Confidential.

IV. O&M EXPENSES

A. THE DEPARTMENT SHOULD DENY THE COMPANY'S PROPOSED PRO FORMA ADJUSTMENT TO PROPERTY AND LIABILITY INSURANCE BECAUSE IT IS EXCESSIVE AND THE COMPANY DID NOT TAKE ADEQUATE STEPS TO CONTAIN COSTS.

The Company contends that the pro forma increase to its test year Property and Liability Insurance expense for its electric division is known and measurable and that it is entitled to that adjustment. Co. IBr., pp. 66-67.

The issue, however, is not whether the increase is known and measurable, but whether the Company took reasonable and adequate steps to control insurance costs after its carrier notified Fitchburg that its insurance bills would double. The Company explains reasons for the bill increase, but does not show that it took sufficient steps to control the substantial increase in its insurance expense. Co. IBr., pp. 68; *see also*, Tr. 13, pp. 1560-1564. The Company also misleadingly lumps together alleged efforts to contain one type of insurance---D&O insurance---with a wholly separate category, property and general liability insurance. Co. IBr., pp. 68-69. The Company's alleged cost containment actions in one insurance category do not justify its lack of action in another insurance category. Apparently, the only containment action the Company can identify is bidding or benchmarking all of its insurance policies every five years, and sometimes as often as every three years. *Id*. at 68. The Company admits, however, that it did not bid or benchmark its policies this year, even after notice of a doubling of costs on one of its policies.[13] *Id.* The Company has not pointed to any record evidence demonstrating that it

[13] The Company attempts to defend its failure to issue an RFP for this policy by arguing that it is very expensive to issue an RFP every year. Co. IBr., p.68. Even if this is so, the Company has provided no justification for its failure to take any other cost containment measures when faced with essentially a 100% increase in cost for a certain insurance policy.

attempted to contain its costs with respect to property and general liability insurance. The Department should therefore reject the Company's proposed pro forma insurance expense; and disallow any insurance cost recovery greater than the test year amount.

The Company also attempts to defend its annual payment of a $15,000 brokering fee to McCarthy Insurance Agency for negotiating the Company's directors and officers' liability insurance premiums with Aegis by asserting vaguely that the broker provides "beneficial services." Tr. 11, pp. 1379-80; FGE IBr., pp. 68-69. This brokering fee should not be charged to ratepayers as an expense because it does not meet the Department's "reasonable and valuable" standard. *Berkshire Gas Company*, D.T.E. 01-56, p. 67 (2002). The amount is excessive for the work involved, and the Company already maintains a membership with Aegis, which presumably entitles the Company to certain insurance premium advantages over non-members. Tr. 11, p. 1380. The value to the ratepayer of a broker's services is unsubstantiated here; the premium increased 118% despite the broker's involvement, and yet the Company failed to seek quotes from another broker or conduct an RFP for replacement D&O coverage. The record contains no evidence to justify charging ratepayers $15,000 for a brokering fee without any evidence that the broker provided any valuable services. The Department should eliminate the $15,000 broker's fee from the property and liability insurance expense adjustment.

B. THE COMPANY OVERSTATES ITS BAD DEPT EXPENSES

The Department should not allow the Company to include certain substantial and **extraordinary**[14] gross writeoffs in the month of December in its pro forma bad debt expense

[14] The Company acknowledged that for the months January through November, the average electric gross write-off per month was $39,521 and the average gas gross write-off per month was $36,727. Tr. 15, p. 1916. For the month of December, however, the Company recorded an electric gross write off of $225,109 and a gas gross write–off of $302,228.

calculation. Under the Department's precedent and methodology for calculating bad debt expense, the Company should use its most recent three years of actual writeoffs **net of recoveries** for determining the appropriate level of uncollectible expense for inclusion in cost of service. *See Boston Gas Company*, D.P.U. 96-50 (Phase I) , at 70-71 (1996); *Berkshire Gas Company*, D.P.U. 90-121, at 96-97 (1990); *Western Massachusetts Electric Company*, D.P.U. 84-25, at 113-114 (1984). The Company's methodology does not comply with Department precedent and methodology. *See* AG IBr., p. 21. Indeed, the Company's methodology skews the Department's standards and methodology by stockpiling **extraordinary** amounts of gross writeoffs in the last month of the test year, avoiding the recognition of possible recoveries that may occur in the following month(s) in the next year----a year which falls outside of the three-year bad debt expense calculation. *See* AG IBr., p. 22-23.

The Company cites various monitoring efforts it claims it undertook once its auditors notified it of the potential arrears problem, and Fitchburg suggests that the moratorium on shut offs contributed to the problem. The Company lauds its alleged efforts to reduce the level of bad debt in the test year. Co. IBr., p. 73. The Company fails to justify, however, the recording of extraordinary writeoffs in the month of December instead of some earlier month that would have allowed the reflection of recoveries on these extraordinary writeoff amounts. The Company also fails to explain why it failed to follow its own rules and procedures and, indeed, general industry practice regarding over 90-day and over 120-day arrears, rules and procedures and industry practice that could have prevented the stockpiling of **extraordinary** writeoffs in the test year month of December. The Department should achieve a more representative uncollectible expense by directing the Company to perform its calculations using the average gross writeoffs per month for the months January through November in the test year. *See* AG IBr., p. 23.

C. THE COMPANY'S METHODOLOGY IN AMORTIZING SOFTWARE AND TECHNOLOGY ASSETS IS INCONSISTENT AND IRREGULAR AND RELATED EXPENSES MAY BE IMPROPERLY ALLOCATED.

The Company contends that its proposed software and technology amortizations are reasonable in amount and length and should be approved. Co. IBr., p. 102. The Company uses inconsistent amortization periods for similar assets, however, and fails to amortize costs for the respective year of purchase or upgrade. AG IBr., p. 24.

The Company fails to cite any record evidence that shows that its software amortization periods are consistent and accurate.[15] To the contrary, the record reveals that the Company treats similar software and technology assets with varying amortization periods of 36 months, 55 months, 60 months, 73 months, 84 months, 89 months, and 101 months. DTE-RR-4; Exh. AG-7-65 (electric); DTE-RR-24.

The Company's only response to the charge that it fails to amortize costs for the respective year of the purchase or upgrade is to claim that the year of the purchase or upgrade is not necessarily the year in service for that asset or the year when useful life commenced. Co. IBr., p. 102. The Company, however, cited no evidence showing, for any of the items or assets referenced by the Attorney General, that the useful life or the in-service date commenced at a different time than the purchase of upgrade. *See* AG IBr., p. 24. Further, the Company did not explain why it actually purchased or upgraded an asset in one year but reflected no amortization until a subsequent year. Finally, the Company failed to explain the discrepancy, 1997 versus

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[15] Instead, Fitchburg merely argues that the Attorney General did not challenge the reasonableness of a particular addition or the length of amortization proposed. Co. IBr., pp. 101-102. The Company failed to recognize the Attorney General's reference to "inconsistent amortization periods" as a general challenge to the length of amortization proposed. This complaint, coupled with the recommendation that the Department direct the Company to be consistent in the amortization periods it uses for similar assets, clearly contests the length of amortization proposed. *See* AG IBr., p. 24.

1998, in its reported commencement of the amortization on its computer system. *Id.* at 24. The Department should reject the proposed increase to the test year amortization expense, and direct the Company to amortize its software and technology assets from the in-service date of that asset and to reconcile or otherwise be consistent in the amortization periods it uses for similar assets.

The Company did not respond to the Attorney General's contention that certain affiliates of the Company, such as Unitil Service Corporation, use and benefit from the software and technology assets and that the amortization costs of these assets should be allocated to all affiliates that use or benefit from them. *See* AG IBr. p. 25. The Department, therefore, should direct the Company to allocate amortization costs to all affiliates that use or benefit from the software and technology assets.

D. THE DEPARTMENT SHOULD REDUCE THE PROPOSED NON-UNION WAGE ADJUSTMENT TO ALIGN THE COMPANY'S TOTAL COMPENSATION WITH THE COMPARABLE INDUSTRY MEDIAN.

The Department should disregard the Company's assertions regarding its non-union wage increase adjustment. First, the Company puts forth information about the Hay Survey and comparisons it used without any support in the record and without the required motion to reopen the record. FGE IBr., p. 53. Mr. Collin did not provide any testimony supporting the point, and the Company did not present a witness from Hay to make such assertions. The Department should strike this unsupported information from the Company's initial and reply briefs and accord no weight to the information.[16]

Second, the Company does not account for the higher-than-average level of benefits that

[16] "All evidence, including any records, investigation reports, and documents in the possession of the agency of which it desires to avail itself as evidence in making a decision, shall be offered and made a part of the record in the proceeding, and no other factual information or evidence shall be considered, except as provided in paragraph (5) of this section." G.L. 30A, § 11(4).

its employees receive in addition to salary, and does not address evidence that the combined wage and benefit package greatly exceeded both the industrial and utility averages. DTE 4-5, page 8 of 90; AG IBr., p. 30. The Hay Group findings reported in DTE 4-5 show that the Company's total benefit program was significantly higher than the median for the top two wage earners in the Company – the President/Chief Operations Officer and the Senior Vice President – due to their supplemental executive retirement plan. Tr. 1, pp. 95-98; DTE 4-5, pages 8 and 25 of 90.

Using total wages alone, as the Company does, will not give the Department the complete view of the Company's competitiveness for hiring qualified workers. FGE IBr., p. 56.[17] The Company claimed that it was below median salary on average on five job grades, when in fact three positions exceeded the 2001 Hay Survey Median, using all industrial companies for comparison. Exh. AG-5-14.

The Department has several alternatives to bring the Company's total wage and benefit compensation package in line with the industry median: (1) disallow the Company's proposed adjustment for non-union wages; (2) allow the proposed adjustment for non-union wages but reduce the adjustment to reflect a reduction of the Company's benefit program to the level of the industry median; or (3) reduce the proposed adjustment attributed to a reduction in the benefit levels of the top two wage earners necessary to bring their overall wage and benefit compensation package in line with the industry median. Fitchburg has not provided any

[17] Even looking at the incomplete compensation evidence cited by the Company reveals there are salaries above the median. FGE IBr., p. 55. The Company's salaries for Job Grades 14, 15, 17, and 20 all exceeded the 2001 AGA Survey of median midpoint using companies with $150 to $400 million in revenues, which is more specific and much closer to the Company's revenue level than the under $1 billion level used by the Company. Exhibit AG-5-14.

evidence that, with such increases, its non-union employee total compensation is reasonable and in line with similar utility employees of other companies. Accordingly, the Department should reduce the proposed adjustment to bring the Company's total compensation package in line with the industry median. AG IBr., p. 29; *Berkshire Gas Company*, D.T.E. 01-56, p. 54 (2002).

E. THE DEPARTMENT SHOULD REDUCE THE PROPOSED ADJUSTMENT FOR POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS ("PBOPS")

The Company contends that its FAS 106 accrual and its Unitil Retirement Trust estimated contribution expenses should be included in the pro forma adjustment to O&M expenses (FGE IBr., pp. 65-66). The Department, however, requires that trust fund expenses must be tax deductible to be known and measurable; only actual cash contributions to a tax-deductible trust are counted as an adjustment to the cost of service. *Massachusetts Electric Company*, D.P.U. 95-40, p. 39 (1995); *Massachusetts Electric Company*, D.P.U. 92-78, p. 83 (1992). The Company has failed to establish, and contribute cash to, a trust that would result in legitimate, known and measurable tax deductions that would be includable in the cost of service.

The Company argues that it is saving ratepayers money by not creating a formal trust. FGE IBr., p. 66. This argument is not supported by evidence in the record. The Company has provided no persuasive argument for the Department to depart from its precedent, so the Department should disallow the FAS 106 accrual and Unitil Retirement Trust estimated contribution expenses for post-employment benefits for current employees.

F. THE DEPARTMENT SHOULD DISALLOW PROPOSED MEDICAL AND DENTAL EXPENSE INCREASES BECAUSE THEY ARE NOT KNOWN AND MEASURABLE AND ARE UNREASONABLE IN AMOUNT.

The Company proposes a 21% ($60,573) *pro forma* increase to its Medical and Dental expense. FGE IBr., p. 61. Although Fitchburg claims that this expense is known and measurable, in fact it is based on unreliable **estimates** of claims provided by its carrier, Anthem Blue Cross/Blue Shield ("Anthem").[18] *Id.*, pp. 58-62. The Company's expense is based on a snapshot taken at the middle of the claims process (*i.e.*, when Anthem gives the Company its estimate of expected claims for the upcoming year). Rate recovery should instead reflect the amount actually and finally paid, including true-ups resulting from the claims process, which compares medical bills actually paid to providers' estimates of claims.[19] The Department should reject the Company's proposed *pro forma* adjustment because it is based on estimates rather than final actual costs, and therefore is not known and measurable. *Berkshire Gas Company,* D.T.E. 01-56, p. 60 (2001); *Boston Gas Co.*, D.P.U. 96-50 (Phase I), pp. 45-46 (1996); *North Attleboro Gas Co.*, D.P.U. 86-86, p. 8 (1986).

The Department should also reject the Company's 21% *pro forma* estimated increase because it is unreasonable in amount. Fitchburg's own actuaries forecast an increase of only 11%. AG-RR-62.

G. THE DEPARTMENT SHOULD REJECT THE PROPOSED INCENTIVE COMPENSATION PLAN EXPENSES BECAUSE THE PLAN AS STRUCTURED DOES NOT BENEFIT CUSTOMERS.

In reviewing the Company's proposed adjustment to payroll expense attributed to Company incentive plan payments, the Department must determine whether the Unitil Corporation Incentive Plan ("Incentive Plan") has defined goals and quantifiable benchmarks. The Company asserts that its Incentive Plan meets this Departmental standard.

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[18] The reliability of Anthem's claims estimates is untested. Also, Anthem has an incentive to inflate the estimated claims because its fee is based on those estimates.

[19] Even the Company's "true-up" information regarding medical self insurance plan costs is based on estimated claims payments, not on actual claims paid to the underlying medical providers. Exh. AG-1-63(E).

The Attorney General challenges the Incentive Plan regarding three incentive goals: (1) subjective evaluations [with 20% goal weight], (2) Usource/new business initiatives [with 10% or 20% goal weight], and (3) Core Utility Earnings [with 30% or 40% goal weight]. DTE 4-9, Attachment 1, page 7 of 7; Attachment 2, page 8 of 8; Attachment 3, page 1of 1. These three goals constitute 70% - 80% of the Incentive Plan goal weight, are undefined and unquantifiable .

The Company admits that the goal weights for Usource/new business initiatives and for earnings were adjusted or normalized during the test year. Co.IBr, p. 96; Exh. DTE 4-9. The Company refers to a "normalized" evaluation of the 30%/40% earnings goal weight, but does not sufficiently justify using a normalization approach. The Company does not deny that its subjective evaluations category is based on variable criteria. Also, shifting the goal weights during the year undermines the incentive aspect of the Incentive Plan; employees are falsely lead to believe their paychecks will be bigger if they achieve specific goals that have specific weights. For example, a company that promises rewards for great customer service at the beginning of the year, but changes that promise at the end of the year and reduces that goal weight, has mislead its customer service-based employees.[20]

The Company's ratepayers should not be charged the expenses of such a poorly structured employee incentive plan. The Department should order the Company to revise its Incentive Plan to prevent goal weight shifts after the beginning of each year and to eliminate the subjective evaluation category. The Department should disallow all expenses in the cost of service arising from the Incentive Plan.

[20] By requiring the Company to keep its goal weights once set at the beginning of the year, the Department could help stabilize the Company's Incentive Plan.

H. THE DEPARTMENT SHOULD ORDER ADDITIONAL ALLOCATIONS TO NON-UTILITY OPERATIONS, BUT SHOULD NOT USE A BLANKET REVENUE ALLOCATOR FOR OTHER EXPENSES.

The Company rightly acknowledges its error in not allocating a portion of the Account 925 liability expense according to a non-utility/total utility revenue allocator. AG IBr., p. 32; FGE IBr., p. 92; *Blackstone Gas Company*, D.T.E. 01-50, Order, pp. 10-12 (2001) (corrected). The Company also agrees that it should use the revenue allocator, 1.802% Gas and .072% Electric (Exh. FGE-MHC-7), to allocate a portion of the Account 926 URT retiree trust fund, the property taxes, and the amortization of intangible software expenses. FGE IBr., pp. 92-93. The Department, should order the Company to make these additional uncontested allocations to non-utility operations.[21]

The Company, however, in footnote 29 of its brief, makes the extraordinary and inappropriate suggestion that the Department use the non-utility/utility revenue allocator for all accounts not yet allocated and for all pro forma adjustments. FGE IBr., p. 92, n. 29. The Company does not even specify which portions of which accounts would be affected and the Department should reject Fitchburg's blanket application of the revenue allocator. Such a proposal is contrary to all of the appropriate Department precedent based on cost causation principles.

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[21] The Department, however, has no record to support the Company's assertion that it properly allocated its medical and dental expense to non-utility operations. Therefore, the Department should apply the non-utility/utility revenue allocator to the medical and dental expense as part of the pro forma adjustment for payroll expenses.

I. THE COMPANY FAILED TO REMOVE THE AMORTIZATION OF THE CAPITALIZED LEASE FROM THE COST OF SERVICE

Generally Accepted Accounting Principles to treat certain of its leases as assets and capitalize them on its financial books. Although the Company has agreed to remove its capitalized lease from rate base and convert its accounting for the lease from a capitalized lease to an operating lease for ratemaking purposes, the Company has failed to properly remove the amortization of the lease asset from its cost of service. AG Br., pp. 17-18; Co. Br. p. 24.

The Company proposes, for ratemaking purposes, to convert the lease from a capitalized lease to an operating lease. This requires that the Company remove all of the costs components of the capitalized lease, the interest expense and the amortization of the lease asset, and substitute for those costs the annual operating cost of the lease. Here, the Company has removed the interest expense, but has failed to remove the amortization of the lease asset. Thus, the Company has failed to remove all of the capitalized lease costs. This results in a double recovery of some of the costs of the lease, and the Department should order the Company to remove the capitalized lease from rate base as well as all of the annual cost components associated with the capitalized lease that are included in the cost of service before the operating lease is included.

J. THE DEPARTMENT SHOULD INCLUDE THE ACCUMULATED DEFERRED INCOME TAXES ASSOCIATED WITH ACCRUED REVENUE IN RATE BASE

The Company proposes to reduce its balance of accumulated deferred income taxes for a claimed balance associated with Accrued Revenue. Exh. FGE-MHC-1, Schedule MHC-11, p. 1, lines 11-12. (electric) and (gas). Indeed, the cases that appear in the Company's brief require the inclusion of all accumulated deferred income taxes in the determination of rates. Co. Br., pp. 39-

40. The Company first relies on D.T.E. 99-118, its last base rate review for its electric division. There, the Department found that it was appropriate to allocate the accumulated deferred income taxes to the generation function for inclusion in the determination of the transition charge. *Fitchburg Gas & Electric Light Company*, D.T.E. 99-118, p. 40 (2001). Since customers are credited for those accumulated deferred income taxes through the transition charge, they are made whole for their contribution of zero cost funds to the Company. Here, however, the Company does not have rate base or investment to credit through the Standard Offer and Default Service charges. Therefore, the benefit of these zero cost funds flow directly to the Company's shareholders.

The Company also mistakenly relies on the Department's Order in *Essex County Gas Company*, D.P.U. 87-59 (1987), as supporting its position regarding the accumulated deferred income taxes associated with the gas division. *Id.* (the Company inadvertently cites page 63, when, apparently the only section in the Department's Order regarding accumulated deferred income taxes is on pages 27 to 29). The Department in fact ordered that company to include the accumulated deferred income taxes associated with gas costs in the determination of gas distribution rate base, finding that "test year-end balances of deferred income taxes, regardless of their sources, represent a cost-free level of funds available to the Company and as such must be treated as a reduction to rate base." (citing *AT&T Communications of New England,* D.P.U. 85-137, p. 31 (1985)).

Finally, it should be noted that the Company has asked to recover claimed costs associated with cash working capital for its electric supply costs through its distribution rates. Exh. FGE-MHC-1, Schedule MHC-4-1 (electric). With this proposed adjustment, the Company seeks to recover through its distribution rates, its claimed cash working capital costs for its

Standard Offer and Default Service, to ensure that its shareholders are made whole for any invested funds, even though those costs are collected through a separate rate. The Department should treat the Company's customers fairly and symmetrically by having those balances of accumulated deferred income taxes associated with accrued revenues deducted from rate base. *Essex County Gas Company*, D.P.U. 87-59, pp. 28-29 (1987).

K. THE DEPARTMENT SHOULD REJECT THE COMPANY'S EXPENSING OF METER REMOVAL COSTS

The Company has inappropriately expensed the cost of removal for its meters. The record shows that the Department's accounting instructions for meter removal provide that a utility may expense those costs only in those circumstances when there is "removal ***<u>and</u>*** resetting" for future installation. *See* Exh. AG-4-21, p. 42 (emphasis added). The Company argues that (1) the Attorney General is confusing plant account instructions with expense account instructions; and (2) the Department has "tacitly accepted" its approval for years. Co. IBr., pp. 93-94. Both of these assertions are incorrect.

First, the Company should charge all plant removal costs to be charged to the balance of Accumulated Depreciation of Utility Plant In Service. Uniform System of Accounts, Account 254. There are no exceptions, no conditions to that instruction. Only in the instance where the meter is removed for resetting and future replacement, essentially a maintenance function, can the cost be expensed. These instructions are separate and very clear.

Second, the Company's citation of *Commonwealth Electric*, D.P.U. 89-114/90-331/91-80 does not support its position regarding the expensing of meter removal and resetting. According to the Company:

> The precedent of expensing all removal costs relative to electric and gas meters is long established, is followed by most of, if not

> all, Massachusetts utilities, and has been tacitly accepted by the Department for several years See Re Commonwealth Electric Co., D.P.U.89-114/90-331/91-80 (July 1, 1991) (Cost of removing and resetting meters in recurring expense properly included in cost of service).

Co. IBr., pp. 93-94. Nowhere in that order does the Department approve the allegedly "established" accounting treatment. *Id.* The record includes no evidence that the Department has "tacitly accepted" this approach. The Department, therefore, should reject the Company's treatment of meter removal costs and order the Company to reduce its cost of service accordingly.

L. THE COMPANY HAS NOT PROVEN THAT THE UNITIL SERVICE CORPORATION INTEREST EXPENSE CHARGED TO FITCHBURG IS A NECESSARY COST OF PROVIDING UTILITY SERVICE

Fitchburg included in its revenue requirement, operations and maintenance expenses $344,945 of interest expense that Unitil Service Corp. charged to the Company during the test year. The Company argued that (1) interest expense is a "legitimate" cost, and therefore, must be included in the cost of service; (2) the SEC required the Service Corp to charge out all of its costs to the operating companies, and, therefore, it must be legitimate; (3) since the Service Corp. provides services that benefit Fitchburg, any and all interest expense that is charged from the Service Corp. must be *per se* "legitimate and appropriate." Co. IBr., pp. 78-79. The sum and substance of these arguments is that the Service Corp. interest expense charge should be recoverable from customers simply because the Company has deemed it "legitimate."

The fact that the Department allows a utility to include interest expense in the determination of the revenue requirement does not mean that any and all interest expense should be included. A utility recovers its cost of capital, including interest expense, in the form of a return on rate base or the net investment that the firm has made in providing current utility service to its customers. The Department carefully scrutinizes the plant in service and other investment components that make up the Company's rate base. The investment has to be a prudently incurred, used and useful cost of providing current utility service. The Company has not shown that any of the Service Corp. investment meets these basic requirements. Furthermore, the Department normally reviews and approves stock and debt issuance amounts and costs to ensure that they are reasonable and necessary. *See* G.L. c. 164, § 14; *Fitchburg Gas and Electric Light Company v. Department of Public Utilities*, 394 Mass. 671, 678-679 (1985) ("A proceeding pursuant to G.L. c. 164, § 14, is meant to serve as a screening mechanism to shield the public from the effects of management's unchecked discretion. . ."). The Department has not reviewed any of the Service Corp. issues for their reasonableness.

The legitimacy of the interest expense amount is certainly in doubt when the Service Corp. increases its short-term debt during the test year from $991,000 at the beginning of the year to $6,348,000 at the end of the year, during a period when overall short-term debt of Unitil plummeted from $32,500,000 to $13,800,000. Compare Exh. AG-1-7 (2) page 6 and page 12. Furthermore, during that same period, Unitil's unregulated business, Unitil Resources, Inc. saw its debt drop from $1,381,000 to zero dollars, an irregular result for a firm that has been losing money since its inception. *Id.*; Exh. AG-1-7 (2), pages 2 and 8. The apparent ease with which the holding company makes intra-corporate "assignments" of debt and debt expense to the various Unitil affiliates calls into question their reasonableness. Unitil Service Corp. is not accountable to the Department for its financing, these borrowings are essentially unreviewable by the Department since the money can be moved around with ease to maximize Unitil Holding Company's profits.

The Company has not shown that the interest expense charge from the Unitil Service

Corp. during the test year was prudent and reasonable The Department, therefore, should deny the recovery of the interest charges to Fitchburg during the test year in this case.

M. THE DEPARTMENT SHOULD REJECT THE COMPANY'S PROPOSED DEPRECIATION ACCRUAL RATES.

In this case the Company proposes to increase its depreciation accrual rates to a level that would be among the highest in the state. Specifically, Fitchburg proposes a 54 percent[22] increase in its composite electric depreciation accrual rate to 4.73 percent, 20 percent higher than the composite depreciation accrual rate of Massachusetts Electric Company, currently the highest in the state.[23] Furthermore, the Company now seeks to assess gas customers, who experienced a 46 percent[24] increase in the composite depreciation accrual rate in the Company's last base rate case three years ago, an additional 13.5 percent increase in their composite rate.[25]

The Attorney General argued that: (1) Company witness James Aikman's testimony was contradictory to the opinions of the Company's depreciation witness in its last base rate case; (2)

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[22] The current depreciation accrual rate for the electric division is 3.06%, and the accrual rate that the Company proposes is 4.73%, indicating a 54% increase in the rate [4.73 / 3.06 - 1 = 0.54]. *See* Exh. FGE-MHC-1, Sch. MHC-7-17 (electric).

[23] Massachusetts Electric Company depreciation accrual rate can be determined from its Annual Return to the Department. The depreciation expense for calendar year 2001 was $80,772,551 and the average balance of depreciable plant was $2,045,114,000 for an average accrual rate of 3.95% [$80,772,551 / $2,045,114,000]. Compare Form 1 pages 336 and 337. The Attorney General asks the Department, pursuant to 220 CMR 1.10(3), to incorporate those pages by reference.

[24] The composite depreciation accrual rate for the gas division that existed before D.T.E. 98-51 was 2.77%, and the accrual rate that resulted from that case was 4.06%, indicating a 46% increase in the rate [4.06 / 2.77 - 1 = 0.46]. *See* D.T.E. 98-51, p. 70 and Exh. FGE-MHC-1, Sch. MHC-7-20 (gas).

[25] The current composite depreciation accrual rate for the gas division is 4.06%, and the composite accrual rate that the Company proposes is 4.61%, indicating a 13% increase in the rate [4.61 / 4.06 - 1 = 0.13]. *See* Exh. FGE-MHC-1, Sch. MHC-7-20 (gas).

Mr. Aikman failed to perform a gas main and services analysis by material type as ordered by the Department, thus skewing his average service lives of all pipe towards cast iron, which represents a disproportionately small dollar amount of main and pipe plant; and (3) Mr. Aikman's rapid proposed changes in his net salvage value analysis are inconsistent with his long-held "conservative" life analysis methodology, causing him to overstate greatly the cost of removal and the resulting depreciation accrual rate.[26]

Fitchburg seems to argue that the Department must rely on the "opinion" of the Company's depreciation expert, even when that opinion is contrary to the statistical information. The alleged sanctity of the expert opinion is undermined here by the fact that Mr. Aikman's testimony conflicts with the testimony and the results of the ***Company's*** own witness from the last gas base rate case just four years ago. The Department should not allow Fitchburg to change its depreciation accrual rates rapidly just because it has a new expert, especially where the new expert has rashly departed from his own long-held conservatism.

1. AVERAGE SERVICE LIFE ANALYSIS

The Company argues that Mr. Aikman's failure to provide a mains and services average service life analysis by plant type is justified because Mr. Aikman did not have enough time to perform the study for this case. The Company offers to perform such an analysis for its next base rate case. Timing is not an excuse for failing to perform the analysis here. The order requiring the pipe analysis by material type was issued on January 31, 2002, three and one-half months before the Company filed its case on May 17, 2002, and Mr. Aikman took only two

[26] The Attorney General never stated nor did he mean to imply, as the Company incorrectly suggests, that Mr. Aikman's study produces conservative results. The results are anything but conservative, as indicated by his very high negative net salvage amounts and the resulting depreciation accrual rates, which would be the highest in the state. Co. Br., p. 162.

months to perform the rest of his analysis of all of the other plant accounts for the gas division. The next rate case would be too late; under the Company's currently proposed price cap plan, it could be eleven to twelve years from now before Fitchburg's next base rate case. During that period, the Company could grossly over-recover the costs of its mains and services for its plastic and coated steel pipe. Mr. Aikman's opinions and results regarding the mains and services are unreliable without the omitted materials analysis, since the skewed weighting of cast iron pipe is artificially shortening the average lives of mains overall. For these reasons, the Department should reject any change in the depreciation accrual rates for the gas division plant.

2. Negative Net Salvage Analysis

The Company argues, in regard to Mr. Aikman's inconsistent approach to performing his negative net salvage analysis and his life analysis, that the analyses are different because the estimates are different. The Company misses the point. The "conservative" nature of Mr. Aikman's approach should be not associated with costs versus lives. Rather, it is associated with the "wild fluctuations" in any component that causes dramatic changes in the depreciation accrual rates, whatever the source. Mr. Aikman's net salvage value analysis is based on erratic cost of removal measures and retirement balances that are, at best, of little value given that the Company is using a first in, first out ("FIFO") methodology of accounting for its retirements. The Department should require the Company to apply the "incremental change" approach consistently to both the average service life analysis and the net salvage analysis to avoid the rapid fluctuations in the accruals that would result, and deny the Company's proposal to increase its cost of removal estimates as recommended by Mr. Aikman.

If, however, the Department finds that it is appropriate to burden customers with the huge incremental costs associated with these new estimates that are based on the Company's First In

First Out (“FIFO”) methodology, consistency would require that the Department also move to the average service lives indicated by Mr. Aikman actuarial studies, where they fall outside the bounds of the analyses that he has provided. The Department thus should reject Mr. Aikman’s average service life (“ASL”) recommendations based on his “experience,” since they do not incorporate FIFO, and replace them with the following amounts, which reflect the actual statistics under the Company’s FIFO methodology.

ELECTRIC PLANT ACCOUNTS, AVERAGE SERVICE LIVES

Account 353 – Transmission Station Equipment, the Department would use an ASL of 52 years, which is the average of all of the best fitting curves and the within the range of the number one ranked curves for the 10, 20 and 30 year band analyses.

Account 355 – Transmission Towers and Fixtures, the Department would use an ASL of 87 years, which is above the average of all of the best fitting curves and well below the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which were from 87 to 103 years.

Account 361 – Distribution Structures and Improvements, the Department would use an ASL of 74 years, which is below the average of all of the best fitting curves and at the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses.

Account 362 – Distribution Station Equipment, the Department would use an ASL of 48 years, which is the below the average of all of the best fitting curves and at the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses.

Account 364 – Distribution Poles, Towers and Fixtures, the Department would use an ASL of 45 years, which is within the range of the average of all of the best fitting curves yet well below the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which were as high as 70 years.

Account 365 – Overhead Conductors and Devices, the Department would use an ASL of 76 years, which is above the average of all of the best fitting curves and at the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which were from 76 to 81 years.

Account 366 – Underground Conduit, there appears to be fewer retirements and therefore, the Department would use look to those curves with the highest Cycle Indices which indicate a ASL of 64 years, which is within the range of those curves with the highest Cycle Index for the 10, 20 and 30 year band analyses, which were from 64 to 66 years.

Account 367 – Underground Conductors and Devices, the Department would use an ASL of 70 years, which is at the lower end of the range of the average of all of the best fitting curves, yet well below the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which ranged from 114 to 127 years.

Account 369 – Services, the Department would use an ASL of 66 years, which is above the range of the average of all of the best fitting curves and, yet at the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which ranged from 66 to 71 years.

Account 370 – Meters, the Department would use an ASL of 51 years, which is the average of all of the best fitting curves and, yet at the low end of the range of the number one ranked curves for the 10, 20 and 30 year band analyses, which ranged from 51 to 56 years.

GAS PLANT ACCOUNTS, AVERAGE SERVICE LIVES:

Account 311 – LPG Equipment, the Department would use an ASL of 50 years, which represents the midpoint between the average of all of the best fitting curves of 41 years and the ASL of 59 years of the best fitting from the one 31 year band analysis that Mr. Aikman performed.

Account 320 – Other Equipment, the Department would use as ASL of 15 years, which represents the average of all of the best fitting curves as well as the ASL of the top ranked curve.

Account 367 – Mains, the Department would use an ASL of 100 years, which is well below the average of all of the best fitting curves of 102 years and yet within the ASL of the number one ranked curves for the 5, 10, 20 and 30 year band analyses, which ranged from 75 to 111 years. While the Company might argue that 100 years is too long an ASL for mains, it, in fact, is consistent and reasonable with the Company's FIFO methodology for determining the retired mains.

Account 383 – House Regulators, there appears to be fewer retirements and therefore, the Department would use look to those curves with the highest Cycle Indices, which indicate a ASL of 52 years for the one 29 year band analysis that Mr. Aikman performed.

V. COST OF CAPITAL

A. THE DEPARTMENT SHOULD INCLUDE SHORT TERM DEBT IN THE COMPANY'S CAPITAL STRUCTURE.

Although the Department usually excludes short term debt from a company's capital structure, *see, Massachusetts Electric Company*, D.P.U. 95-40 (1995), that precedent is not applicable to the reality of Fitchburg's financing by short term debt. A substantial portion of the Company's total outstanding debt is short term debt. During the test year, 22% or $15, 225,847 of the Company's total outstanding debt consisted of short term debt, a significant percentage that is unusual among utilities in the Commonwealth.[27] *See* AG IBr., pp. 46- 47. Nor is this the first time the Company has had a high short term debt percentage. *Id.* This case, with the Company's unusually heavy and continued reliance on short term debt financing, is distinguishable from the other cases guided by existing Department precedent.[28]

The Company's reliance on short term debt to finance its operations, therefore, creates a windfall to the Company and its shareholders at the expense of customers. The Department should prevent such a windfall by requiring the Company to include short term debt in its capital structure, as is standard for Fitchburg's affiliates in New Hampshire and in several other

[27] The Company argues that short term debt balances are generally considered to be too volatile and not representative of a company's long term capital costs. Co. IBr., p 157. However, the record evidence shows that the Company's short term debt balances are relatively stable, substantial, and representative of a certain level of short term debt over a period of three years. *See* Exh. AG-1-6, Attachment 3(confidential).

[28] The Attorney General asks the Department, pursuant to 220 CMR 1.10(3), to incorporate by reference short term debt schedules from the Company's prior rate case filings, D.T.E. 98-51 and D.T.E. 99-118, to verify that the Company has funded a substantial portion of its operations though short term debt.

jurisdictions.[29] *See, e.g., Re New England Telephone and Telegraph Company*, 14 PUR 4th 295; *Granite State Electric Company*, 28 PUR 4th 240; *Re Public Service Company of North Carolina*, 156 PUR4th 384, p. 419 (1994); *Re Central Illinois Light Company*, __PUR 4th__ March 28, 2002 [131486] .

B. COST OF COMMON EQUITY

Fitchburg on brief, continues to cling to the inflated recommendations of its witness, Mr. Hadaway, that the cost of equity should be one hundred basis points higher than the Company's current allowed return on cost of common equity as determined by the Department from the Company's last base rate case.[30] Co. Br., p. 140. This recommendation flies in the face of the tremendous drop in interest rates that has occurred in the capital markets since that case. Exh. FGE-SCH-1. If, for no other reason, the Department should reject the Company's purposed cost of equity for its failure to recognize this fundamental change in the capital markets, since the last case. Instead, the Department should order the reduction in the Company's allowed return on common equity that reflects the fundamental change in the cost of capital and find that the cost of common equity is 8.67 percent for the electric division and 8.41 percent for the gas division. AG Br., p. 65.

The Attorney General addresses the other positions taken on brief by the Company,

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[29] The Company's cost of short-term debt for the most recent six months available has been 2.35 percent as determined by taking the simple average for that period. The cost of short-term debt can be determined from the most recent six-month period available as shown in Exhibit AG-1-6, Attachment 3, which indicates that the average cost for that period is 2.35 percent. [(2.72 + 2.37 + 2.28 + 2.10 + 2.28 + 2.35) / 6 = 2.35]. Exh. AG-1-6, Attachment 3.

[30] Mr. Hadaway testifies that the Company's cost of equity is 12 percent for the electric division and 11.9 percent for the gas division, although he recommended the use of 11.5 percent for purposes of this case. Exh. FGE-SCH-1, p. 5 (Electric) and Exh. FGE-SCH-1, p. 5 (Gas), respectively. The Department found that the cost of equity for the electric division was 10.5 percent in D.T.E. 99-118. *Id.*, p. 89.

below.

1. THE COMPANY HAS A FUNDAMENTAL MISUNDERSTANDING OF THE BUSINESS WHOSE COST SHOULD BE MEASURED.

The Company, on brief, has the same fundamental misunderstanding as its witness as to which business the Department should be considering when it determines the cost of equity. They both argue that the Department should be determining the cost of capital for businesses other than the electric and gas distribution businesses. Tr. 10, pp. 1144-1145 and Co. Br., pp. 144-146.. In regards to the electric business, he discussed at great length the investment risks associated with energy trading in the Western United States, the risks of the generation business since the deregulation of those markets, and the risks associated with "stranded" generation assets which the Company recovers through its transition charge. Exh. FGE-SCH-1, pp. 24-25 (electric). The Company makes the same fundamental mistake in its brief. Co. Br., pp. 144-145. Equally, Mr. Hadaway believes that the Department should consider unbundling and the introduction of gas supply competition to create some new risk for the gas ***distribution*** business. Exh. FGE-SCH-1, p. 22 (gas). Furthermore, he considers variation in sales due to weather and competition from oil heat to be some mysterious new risk that investors have not seen before and have not included in their analysis of their investments.[31] *Id*. Again, the Company reiterates these same fundamental misunderstandings on brief. Co. Br., pp. 145-146.

The Company arguments, in this regard, and Mr. Hadaway's analysis, fail to recognize that the Department is only setting distribution rates in this case. Therefore, the cost of equity analysis and findings must recognize and adjust for all the differences in investment risk

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[31] The often cited concept of business risk associated with oil heat and propane competition cannot be taken seriously as the natural gas heating business has historically, and today, continues to take away market share from these other heating businesses, in leaps and bounds.

between the distribution business and the other investments that may coexist with them. For instance, the Company suggests that unregulated energy supply risk should be considered by the Department, when those risks should be born by the marketplace, when Fitchburg's distribution business does not provide those services. Co. Br., pp. 144-145 The Company also suggests that the risks associated with its "stranded" generation costs should be included the Department's analysis. *Id*. Those costs, however, are recovered through a separate rate – the transition charge, where the Company receives a full return on its investment in generation assets at the Company's pre-tax overall weighted cost of capital, on a reconciling basis. Finally, many utilities have other non-regulated businesses or affiliates with non-regulated businesses that have investment risks that are different from that of the utility distribution business. AG Br., pp. 50-51. The Company's failure to recognize those differences in investment risk and the required return expectations between the distribution company and those other businesses necessarily causes the analysis and recommendations to be incorrect.

The only thing new that the Company discusses on brief to support its position regarding a heightened risk environment for regulated distribution companies is a *Value Line Investment Survey* quote regarding the performance of gas distribution companies for the next year due to a downturn in the economy. Co. Br., pp. 145-146. While the slowdown in sales may temporarily effect gas company earnings, as it will effect the earnings of all businesses in the U.S. economy, it does not necessarily effect the cost of capital for the investor and his/her long-run expectations. Exh. FGE-SCH-1, p. 14 (the Discounted Cash Flow ("DCF") growth rate is the long-term dividend growth rate). Furthermore, as Mr. Hadaway testified, the DCF approach demonstrates this phenomena: with slower earnings growth, the DCF growth rate may go down, but the dividend yield will go up, yielding essentially the same results. Exh. FGE-SCH-1, pp.

11-14. Therefore, earnings growth, by itself, does not change the cost of capital for a firm, especially when it is only temporary.

2. Mr. Hadaway Made No Adjustments To His Comparison Group Results For The Higher Risks Of The Non-Utility Businesses Within Those Firms

The Company argues on brief that Mr. Hadaway did the best he could to create a comparison group that best reflects the investment risks faced by Fitchburg. Co. Br., pp. 147-148. Certainly, it is nearly impossible to create a significant sample of firms that are purely distribution companies facing the exact same risks as Fitchburg. However, the non-utility businesses that the firms in the comparison group engage in are, in many cases, significant not only in terms of their impact, in some cases negative impacts, on earnings, but they also in terms of the perception that investors have of the firms as they stray away from the core business of a basic distribution utility. See Exh. AG-6-15 (electric) and Exh. AG-8-15 (gas). Mr. Hadaway made no attempt to adjust his results for the higher risks associated with these non-regulated businesses, whether they were energy trading, oil and gas exploration, or telecommunications. AG Br., pp. 50-51. Without recognition of the higher risks and higher investor required returns for these other businesses, the best that can be said for Mr. Hadaway's results are that they are over-inflated and cannot be used to determine the cost of capital for Fitchburg's distribution companies, gas or electric.

3. There Is No Evidence In The Record That Supports The Company's Position That Distribution Utilities Will Grow Faster Than The Economy.

The Company, on brief, goes to great lengths to support Mr. Hadaway's DCF growth rate estimates for his comparison groups. Co. Br., pp. 151-152. However, his growth rate estimates are not supported by the evidence in the record, they are not logical, and they fly in the face of the evidence that the Company itself cites in this case.

The growth rates that Mr. Hadaway relies on were derived from sell side stock analysts. Exh. AG-6-18 (electric) and Exh. AG-8-18 (gas). Those sales men and women are employed to promote the sale stocks by promoting their growth prospects. As the stock market has recently found, this results in their earnings forecasts being well out of line with the underlying fundamentals of the companies. The situation is no different with the firms in Mr. Hadaway's DCF growth rate forecasts. Here, his average forecast long run growth rate for his comparison group companies is 350 basis points to 450 basis points higher than the earnings per share growth rates over the last ten years, a period of unprecedented growth in the economy. AG Br., pp. 54-55. Mr. Hadaway and the Company never address nor do they attempt to bridge the huge gap between the salespersons forecasts and the hard facts of the historical performance for these companies which has been substantially below these forecasts.

Mr. Hadaway use of the sell side analysts forecasts implies that both gas and electric distribution companies can and will grow faster than the U.S. economy. His estimate of 5.94 percent for the electric distribution companies and 7.17 percent for the gas distribution companies, far exceeds the long-run forecasts of the U.S. economy which are generally recognized as being 5.5 percent or less. AG Br., p.54 and Co. Br., p.152. Only if the electric and gas distribution businesses become an ever larger part of the economy would this concept begin to make sense, when in fact through energy conservation, the opposite is probably true. The Company's proposition that the DCF growth rate for gas and electric distribution companies should be greater than that of the economy is illogical at best, and certainly not supported on the record in this case.

The Company, on brief, cites to record evidence in this case which are in direct opposition to the high DCF growth rates that it proposes. The Company relies on a quote from *Value Line Investment Survey* to support Mr. Hadaway's comparison group analysis. Co. Br., pp. 145-146:

> The current operating environment remains unfavorable for gas utilities ... . This industry remains in the bottom tier on the Value Line universe for performance for the year ahead. (*citing Value Line Investment Survey*, March 22, 2002, p. 461).

Notwithstanding the expectation that these firms will be "at the bottom" of the Value Line universe, the Company still forecasts a 7.17 percent short-run earnings per share growth rate, again, more than 150 basis points higher than the economy as a whole. AG Br., p. 54. Clearly, the fundamentals for the economy in general and distribution companies in particular belie the notion that the growth of the companies in the comparison group could be higher than 5.5 percent, or for that matter any different from their historical growth rates in earnings and dividends per share. Therefore, the Department should reject the Company's proposed DCF growth rate estimates in this case.

4. MR. HADAWAY FAILED TO ADJUST HIS RISK PREMIUM ANALYSIS FOR MARKET RISK

Mr. Hadaway performed two risk premium analyses that relied on the market risk premium as measured by the Standard and Poors 500. Exh. FGE-SCH-1, p. 30 (gas). Mr. Hadaway failed to adjust his results to recognize the difference in investment risk between the Standard and Poors 500 and the utility distribution companies. *Id*. The Attorney General proposed appropriate adjustments to Mr. Hadaway's risk premium analysis to correct the errors in his methodology, by using beta, a measure of the risk of the stock investment compared to that of the market as a whole as represented by the Standard and Poors 500. AG Br., pp. 62-64. The Company argued, on brief, that the Department should reject the use of beta because Mr.

Hadaway did not recognize nor did he use beta in his calculations. Co. Br., pp. 153-154. However, Mr. Hadaway's failures are exactly the point.

The Department has found that the cost of equity estimates using market approaches must be adjusted for the risk associated with the particular utility at issue. Without an adjustment for the difference in risk, Mr. Hadaway's analyses represent his estimate of the cost of equity for the Standard and Poors 500, not utility distribution companies. The Attorney General's recommendations simply bring into the risk premium approach the use of beta to adjust for the differences between the risks of the market as a whole and that of the utility distribution companies. The beta statistic is a basic requirement for using the statistics from the Ibbotson survey to determine the cost of equity as recognized by Ibbotson itself. Furthermore, the use of beta has been widely recognized by regulatory bodies, including the Department. Therefore, if the Department is to basis any of its analysis and findings on the risk premium approach in this case, it should adjust those results for beta which yields cost of equity estimates of 6.48 percent to 9.58 percent for Mr. Hadaway's comparison group of electric companies and 7.09 percent to 10.07 percent for Mr. Hadaway's comparison group of gas companies. AG Br., pp. 63-64.

For all of the reasons stated here and in the Attorney General's Brief, the Department should reject Mr. Hadaway's analysis and recommendations in this case. Instead, as was fully explained in the Attorney General's Brief, the Department should find that the cost of common equity for Fitchburg's electric division is 8.67 percent and for Fitchburg's gas division, 8.41 percent.

VI. RATE DESIGN

A. THE DEPARTMENT SHOULD REJECT THE PROPOSED DESIGN DAY ALLOCATION OF GAS COSTS BECAUSE IT WOULD BE CONTRARY TO COST CAUSATION, WOULD NOT REPLICATE EITHER THE MARKET OR CAPACITY ASSIGNMENT AND MAY MAKE THE CGAC UNREVIEWABLE.

The Company understates the significance of its proposed change to gas cost allocation. Co. IBr., p. 108. According to the Company, Mr. Harrison made "one minor enhancement" to the Company's current method of allocating demand costs in the Cost of Gas Adjustment Clause ("CGAC"). *Id.* Mr. Harrison's enhancement, however, is not a minor change; nor does it improve the CGA as is implied by the Company.[32] The change that Mr. Harrison makes consists of allocating certain gas costs to classes first, then to months. To implement his "one minor enhancement," Mr. Harrison uses a design day allocator for the "remaining" load and then uses a proportional reliability allocator to assign each class's remaining costs to the months of the year.[33] The current method employs proportional responsibility allocators to assign costs to classes based on class use under normal weather conditions. This is very different from allocating costs on the basis of estimates of what each class might use on a single day–the design day. The proposed change does not better reflect cost causation. Customer usage is best

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[32] The Company's proposal is not simply a minor enhancement. As discussed below, the scope of the proposed change is so broad and ill defined that it requires that the Company's CGAC tariff language be modified and expanded to state clearly how actual calculations will be performed in each of the Company's future CGA filings should the Department approve the proposal. The design day "enhancement," coupled with the Company's plan to calculate the design day allocators using programs and methods not presented during the proceedings (AG-RR-19 and 45), as well as the additional proposed change to how CGA allowable bad debt costs are to be recovered and reconciled, adds additional complexity to what was designed to be a simple, automatic price change adjustment factor. As discussed below, the added complexity requires that the CGAC tariff contain more detail regarding how the "routine" calculations will be made and costs reconciled.

[33] Allocating costs to months has almost no impact on a class's rate.

reflected in actual seasonal usage patterns rather than estimates of use under extreme conditions, as is proposed by the Company in its "one minor enhancement."

The Company ignores the fact that the design day allocator does not accurately reflect the actual use of LNG and propane. The Company relies on Mr. Collin's testimony to support the use of the design day allocator; he testified regarding the operational (real, not theoretical or estimated or planned) use of LNG (to fill in at times when storage gas is unavailable). His testimony in fact supports the recognition of the benefits to all customers from LNG that is not possible with the use of Mr. Harrison's design day allocator. Co. IBr., p. 109. The Company should allocate costs to the customers that benefit from the underlying services and allocators should reflect how the Company actually provides services to customer classes.[34]

The Company also claims, incorrectly, that because mandatory capacity assignment is based on design day allocations, marketers' portfolios must necessarily resemble the same resource allocation.[35] Co. IBr., p. 109. The comments marketers filed during the gas unbundling

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[34] The Department has long recognized that single event (maximum day, design day, etc.) based allocators are not always appropriate. Single events are resource acquisition and **planning** criteria, but **actual use** should be considered when selecting the most appropriate allocator to be used in assigning costs to the customers enjoying the benefits of the resource. "Although engineering knowledge and judgment play a vital role in cost allocation principles, the Company's decision to allocate 100 percent of its storage facilities to the maximum-day requirement is not supported by the record. While the Department recognizes that, for at least some systems, a maximum-day allocator may be justified, the record evidence demonstrates that Mass-Am's storage facilities play a broader role in the Company's operations than just meeting peak demand requirements." *Massachusetts-American Water Company*, D.P.U. 95-118, p. 162 (1996).

[35] The claim by the Company and its witness, Mr. Harrison (the inventor of the Market Based Allocator), that competitive marketers' portfolios mirror LDC portfolios is not credible. The Department recognized in its order adopting mandatory capacity assignment that competitive suppliers may not even retain assigned capacity to serve migrating load. The Department stated: "Under a mandatory capacity assignment regime, once the capacity is assigned to a customer's competitive supplier, the supplier will have the ability to re-market some or all of the capacity allocated to it and to serve its customers with any combination of resources that the supplier may hold." *Investigation by the Department of Telecommunications and Energy upon its own motion commencing a Notice of Inquiry pursuant to 220 C.M.R. s.s. 2.00 et seq. into the unbundling of all natural gas local distribution companies' services*,

proceedings, where they almost unanimously argued against the mandatory assignment of capacity in favor of a voluntary scheme, *Id.*, p. 20, do not support Fitchburg's assertion. Marketers are not responsible for adhering to design day planning standards imposed on regulated utilities. Competitive suppliers are free to select resources and hedges that can be tailored to specific needs. Even when assigned capacity, the suppliers may choose to use the allocation differently than the assigning utility had, or they may choose to dispose of it altogether.[36] The Department, therefore, should reject the use of a design day allocator because it does not better reflect cost causation, it is not a proxy for competitive market portfolio structures and methodology, and as proposed, it lacks the specificity necessary to incorporate in a tariff.

B. THE DEPARTMENT SHOULD REJECT DOER'S PROPOSAL FOR FURTHER UNBUNDLING OF DEFAULT AND STANDARD OFFER SERVICE ADMINISTRATIVE COSTS IN THIS CASE.

DOER proposes the further unbundling of costs related to the procurement and administration of Standard Offer and Default Service. DOER IBr., p. 5. DOER recommends that the Company "allocate all appropriate costs (direct and indirect) related to the provision of electric generation" to the generation services component of the bill in order to reflect "true cost-causation to the maximum extent possible." DOER IBr., pp. 5 and 25.

The Department is currently conducting an investigation into whether certain

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D.T.E. 98-32-B, p. 13 (1999).

[36] In addition, the Company's Gas Distribution Terms and Conditions contain provisions for capacity mitigation services that would allow marketers to combine their capacity allocations with other capacity release volumes to be offered for sale by the Company. The revenues from the sales would be considered mitigation of the cost of the unusable portion of marketers' capacity assignments. Exh. AG-7-29 (G), p. 49.

administrative costs should be included in Default Service rates. *Default Service*, D.T.E. 02-40. To use the opportunity presented by this rate case to gather data about the character and magnitude of these costs is a reasonable endeavor.[37] This case, however, is not the appropriate vehicle to order an unbundling of costs prior to conclusion of the generic investigation. First, the data the Company provided do not reflect test year costs[38] and was not submitted until after the close of hearings, depriving parties of the opportunity to examine sponsoring witnesses on the validity and propriety of the cost data.[39] Second, the identified costs are not variable, incremental costs and as such would require the concomitant implementation of a reconciling mechanism to assure that the appropriate level of these costs were recovered as customers migrate from utility provided generation services to competitively supplied services. The implementation of a reconciliation mechanism raises subsidy issues, both inter-class subsidies (Standard Offer, Default Service and Competitively served customers) and inter-generational subsidies (future default service customers pay for the costs related to prior generation of default

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[37] Both DOER and Department's staff queried the Company witness regarding costs that may be attributed to providing generation services. Tr. 1, pp.116-143 (DOER) and Tr. 7, pp. 842-878 (DTE).

[38] Using anything other than test year costs could result in a misallocation of costs between distribution rates proposed by the Company based on test year adjusted costs and costs from some other period being allocated to generation rates. This type of misalignment could result in the double recovery of administrative costs.

[39] The Company does not propose to include administrative costs in its Standard Offer and Default Service rates and does not seek to adopt the DOER proposal. Co. IBr. pp. 167-168. The Company has, however, proposed the recovery of bad debt costs through generation service related rate components based on the ability to track these costs for certain rate elements (i.e., generation service type). Exh. FGE-MHC-1 (E), p. 49. The Attorney General is not opposed to this transfer of costs from base rates to generation services charges as long as certain necessary provisions are formalized to ensure the accurate allocation of partial payments and recoveries between base rates and energy charges. See AG IBr., pp.77-78.

service customers' under-recovered costs).[40]

C. THE DEPARTMENT SHOULD REJECT DOER'S PROPOSAL TO INCREASE CUSTOMER CHARGES.

The DOER suggests that economic efficiency[41] requires customer charges be set at higher levels than those requested by the Company.[42] DOER IBr., p. 6. DOER's brief contains extensive discussion and illustrations supporting the movement of the Company's customer charges closer to marginal costs. The Department, however, should reject this proposal for two reasons. Firstly, the marginal cost studies are flawed[43] and should not be relied on at all in designing rates, for the reasons previously discussed. AG IBr., pp. 71-72. Secondly, the DOER

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[40] NSTAR Electric notes that the recovery of "fixed costs from an ever-smaller customer base would be unworkable and would inevitably result in the accrual of a new category of unrecovered costs." NSTAR RBr., p. 5. This would be tantamount to the creation of new stranded costs.

[41] DOER's discussion regarding the development of economically efficient rates does nothing to counter the Company's clear misunderstanding of the process. The Company states in its brief that its rate design is efficient "... because the most inelastic part of the bill is set as close to marginal cost as possible." Co. IBr., p. 132. This statement is inconsistent with Department rate design principles–economic efficiency comes from setting the most elastic rate component close or equal to marginal cost. *Boston Gas Company*, D.P.U. 93-50, pp. 377-379 (1993); *Western Massachusetts Electric Company*, D.P.U. 84-25, pp.173 and 176 (1984). In its attempt to set customer charges closer to marginal costs, DOER reduces the variable charges. This result could significantly devalue the price signal needed to encourage conservation and the ultimate avoidance of incremental costs. Also, higher volumetric rates, rather than customer charges, provide the price information to indicate that customer is using a valuable resource (gas or electricity). In this era of market based energy prices, the information content of prices is not within the control of the Department. Therefore, if the Department wishes to continue to send appropriate price signals regarding consumption to customers, it must do so through distribution rates.

[42] DOER also argues that "inefficient" rates will be perpetuated and further distorted under the operation of the Company's proposed PBR plan. The propriety of implementing the proposed PBR will be addressed in the separate PBR dockets, D.T.E. 02-22 and 02-23.

[43] The Company mischaracterizes the Attorney General's argument regarding the escalation rates Mr. Harrison relied on in developing his marginal costs. Co. IBr., p. 121. The Attorney General stated that Mr. Harrison did not use the correct Handy Whitman indices; not that he should have used something other than Handy Whitman indices. Mr. Harrison acknowledged that there are separate Handy Whitman indices for each plant account, as different types of plant experience cost increases at unique rates–but that he used the same index for all plant accounts. Tr. 4, pp.449-451. This flaw pervades the marginal cost studies.

proposal would violate the Department's rate continuity goal, possibly for the majority of customers, because it would result in significantly higher bills for small, low use customers, both gas and electric. Small, low use bills, for most classes, represent 50 percent of the bills rendered. Compare Exh. FGE-KMA-6(G) and DOER Attachment 5; Exh. KMA-8(E) and DOER Attachment 10. These bill impacts analyses show that implementation of the DOER proposal would produce the following bill impacts for approximately 50 percent of the bills rendered in each class, the half of each class's bills that reflect the lowest monthly use.

GAS (DOER Attachment 5 and Exh. FGE-KMA-1 (G), Schedule KMA-6)[44]

Class	Bill Increase DOER Proposal	Company Proposal
R-1	29-57%	21%
R-3	18-64%	19-20%
G-41	38-94%	14-19%
G-51	16-62%	9-14%

Larger use Gas classes omitted.

ELECTRIC (DOER Attachment 10 and Exh. FGE-KMA-1 (E), Schedule KMA-8)

Class	Bill Increase DOER Proposal	Company Proposal
RD-1	5-33%	4-6%
RD-2	4-17%	1-2%

[44] The above comparisons are based on the Company's original filing, where the bill impacts used a class specific CGA factor based on test year CGA revenue for the "current" rates and test year gas costs allocated based on the Company's proposal for "proposed" rates. Exh. FGE-KMA-1 (G), Schedule KMA-6, notes 2 and 4. Test year gas costs were significantly higher than current costs and their use in bill comparisons masks the real impacts customers will experience if the Company's proposed rates go into effect in December. See RR-DTE-24 (G), peak season bill impacts comparing current rates with CGA filed September 16, 2002, and the proposed rates incorporating the proposed CGA based on September 16, 2002, filed cost data.

GD-1	13-46%	6-13%

DOER did not propose changing any other electric class rates.

The Company has designed its rates to address the Department's continuity concerns and already has proposed the maximum acceptable level of increase for small, low use customers given the rate increase requested.

Another problem with the DOER proposal involves only the electric rates. By statute, all standard offer customers are entitled to a 15% discount, adjusted for inflation, from the rates in effect during August 1997.[45] G.L. c. 164 § 1B. The DOER proposal clearly diminishes and may eliminate the discount enjoyed by this group of customers while shifting a greater benefit to larger, higher use customers within each class. This is clearly an undesirable affect of the proposal that singles out small, low use customers for large percentage negative impacts.

D. THE COMPANY'S CGAC TARIFFS SHOULD BE CLARIFIED.

In its brief, the Company complains that the Attorney General's proposed enhancements to the Cost of Gas Adjustment Clause ("CGAC") and Terms and Conditions ("T&C") tariffs would be burdensome and would lead to customer confusion. FGE IBr., p. 137. The Company also responds to the Attorney General's concern about existing tariff language allowing unauthorized changes to the CGA by claiming that it cannot make such changes because it includes a narrative description of its calculations and provides supporting documentation as part of its CGA filings. *Id.* Neither of the Company's arguments is credible.

[45] The Department has allowed companies to satisfy the discount requirement on a class rather than individual customer basis. The Attorney General asks the Department, pursuant to 220 CMR 1.10(3), to incorporate by reference the Department's Letter to Electric Distribution Utilities, December 17, 1999 (stating position that the discount requirement may be satisfied on a class basis rather than a customer basis).

Since the introduction of competition and the related further unbundling of rates, the CGA has become a very complex set of calculations that no longer simply reflects variability in gas prices. This complexity is now an established part of the Department's rate setting process. The Company should make every effort to help its customers understand the rates they are charged by demystifying the CGAC, which represents a significant part of customers' bills,[46] by making sure that its tariffs are clear, consistent and comprehensive. Fitchburg's customers and any interested person should be able to understand how the Company's rates are calculated.

The Company does not address any of the obvious shortcomings of its tariffs: absence of definitions for key terms (*e.g.*, design day, normal weather conditions, load factor, firm gas sales, and therm) in the CGAC tariff;[47] redundant definitions (*e.g.*, peaking supply, peaking demand, and peaking service) in the Terms and Conditions tariff, and incomplete definitions (*e.g.*, design day allocator, cost of debt, cost of equity, dispatch, acquisition and FERC proceedings costs, and finance charges). These are serious problems, many of which were the result of the implementation, without substantive modification, of model tariffs. The Company now has the opportunity to be a leader in this area by adopting changes to its tariffs, some of which are described below.[48]

The following improvements are suggested to initiate the process of transforming LDCs'

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[46] In Fitchburg's case, more than 60 percent of a residential heating winter bill for 112.07 therms consisted of CGA charges based on the rates in effect in April 2002. DTE-RR-24 (G) Supplemental. Higher usage would increase the CGA percentage, as would a higher CGA rate.

[47] The Company's current Terms and Conditions tariff contains the key term for the mandatory assignment of capacity, which the Company claims is based on a design day allocator, but the tariff does not even define the term "design day." Exh. AG-7-29. This type of omission should not continue.

[48] The recommendations contained in this brief are not exhaustive and the Company should proactively propose additional changes that are consistent with those proposed here.

tariffs into more useful, informative and internally consistent documents than those currently in place. Any modification made to one tariff may require that a related tariff be modified concomitantly to ensure clarity and consistency.

1. Modifications to the CGAC Tariffs.

Section 6.01, Purpose: should be rewritten to be a clearer statement, identify that the CGAC rate is the rate for default service pursuant to §15 of the Company's Gas Terms and Conditions, and to be more comprehensive.

Proposed Language:

> The Cost of Gas Adjustment Clause ("CGAC") establishes a procedure that allows Fitchburg Gas and Electric Light Company, subject to the jurisdiction of the Department of Telecommunications and Energy ("Department"), to determine on a semiannual basis, for the peak and off peak periods, reconciling rates for Default Service pursuant to the provisions of the Company's Default Service tariff and §15 of the Company's Gas Distribution Terms and Conditions tariff ("Terms and Conditions"). CGAC rates are designed to recover gas supply costs, along with any applicable taxes, pipeline and storage capacity costs, local gas costs including local production and storage costs, dispatch, acquisition, FERC proceedings' costs and related overhead costs, the costs of purchased gas working capital, bad debt costs related to gas costs, and gas inventory finance charges. The rates will reflect the seasonal variation in the cost of gas, include credits for supplier refunds, margins from interruptible/non-firm sales net of the amount that is shared with the Company pursuant to Department approval and precedent, and credits for capacity release sales. Separate seasonal CGAC rates will be determined for two customer classes, High Load Factor and Low Load Factor. The CGAC rates are based on a forecast of gas costs incorporating price forecasts, and sales volumes that assume normal weather conditions. An interim adjustment to the seasonal rates is required by the Department whenever the Company anticipates to either over- or under-collect gas costs by 5% or more.

Section 6.02, Applicability: should be modified for clarity.

> **Proposed language**:
>
> The Cost of Gas Adjustment Clause shall be applicable to Fitchburg Gas and Electric Light Company gas sales made under the provisions of the Company's Default Service tariff and Section 15 of the Company's Terms and Conditions. The application of the clause may, for good cause shown, be modified by the Department. See Section 6.11, "Other Rules."

Section 6.03, Cost of Firm Gas Allowable for CGAC: should be modified to indicate that there are separate rates for HLF and LLF customers.

Section 6.03 (4), Bad Debt Costs Allowable for CGAC: should be modified to include language regarding the crediting of recoveries.

> **Proposed addition**:
>
> Bad Debt costs will be credited with all payments received that are attributable to Bad Debt costs previously recovered through CGAC rates.

Section 6.03 (5), Inventory Finance Charges Allowable for CGAC: should state the applicable rate or source/formula used to determine the rate.

Section 6.04, Effective Date of CGAC: should include the dates encompassing the Peak and the Off Peak seasons.

Section 6.05 Definitions: additions and expansions.

Additional definitions–defined as used in the CGAC tariff:

- Capacity
- Capacity Release
- Design Day
- Dispatch
- Dispatch Model
- Firm Gas Sales
- High Load Factor–include the specific rate classes
- Interruptible sales
- Lead Lag Study
- Load Factor
- Local Gas Costs
- Low Load Factor–include the specific rate classes
- Margin
- Margin Sharing–include the percentage shares for Company and Customers and explain how and when shares are determined
- Nonfirm Sales
- Normal Weather
- Proration
- Price Forecast–describe sources and dates of forecasted prices for each element
- Sales Forecast–describe normal weather basis and other key factors

Sales for Resale
Sendout
Therm–include how determined for billing purposes

Definition Expansions:

Cost of Debt and Cost of Equity: should include the specific rate.
Design Day Allocator (if approved for use as proposed): should include explanation of how determined.
Dispatch, Acquisition, and FERC Proceeding Costs (DAFP): should identify the services performed.
Effective Tax Rate: should include the specific rate and the underlying rate components.
Finance Charges (FC): should specify the rate or formula used to determine the rate.

Off-peak Commodity and Off-peak Demand: should refer to costs and underlying resource categories (natural gas, LNG, Propane, etc.).

Peak Commodity and Peak Demand: see Off-peak Commodity and Off-peak Demand.

Production Related Overhead Costs (PRO): should include types/categories of costs (i.e., insurance, corporate services, etc.).

Purchased Gas Working Capital: explanation of working capital and how it is calculated.

Section 6.06, Cost of Gas Adjustment Clause Formulas: should be modified to use only defined terms; whenever an underlying calculation is required to determine an element contained in a formula, the underlying formulas should be described (e.g., Dp/Dop, peak and off-peak demand charges, should describe how the total demand charges are allocated to the periods); sales volumes should indicate that the values used are based on Normal Weather conditions.

New Section 6.06 (A), Description of CGAC calculations: should be modeled on the Company's "Summary of Gas Supply Cost Allocation Methodology to High and Low Load

Factor Rate Classes" as amended to reflect the Department's order in this and future cases.[49] See Attachment to "Summary of Gas Supply Cost Allocation Methodology to High and Low Load Factor Rate Classes" from the Company's September 16, 2002 CGAC filing, Form II, pp. 2-3.

Section 6.09, Application of CGAC to Bills: should include an explanation of proration (when and how).

Section 6.11, Other Rules: should include reference to the Department's requirement for an interim CGAC whenever 5% under or over collection anticipated, citing *Investigation by the Department of Telecommunications and Energy on its own motion regarding the promulgation of rules or the amendment of existing regulations concerning the Cost of Gas Adjustment Clause, 220 C.M.R. §§ 6.00 et seq.*, D.T.E. 01-49 (2001).

Section 6.12, Customer Notification: Should include statement that CGA filings, excluding confidential supplier pricing terms, will be available on the Company's website (provide website URL). The availability of the CGAC filing through the Company's website should serve not only as customer education tool, but also provide marketers with a resource for comparison shoppers.

2. RELATED MODIFICATIONS TO THE COMPANY'S GAS DISTRIBUTION TERMS AND CONDITIONS TARIFF

Section 2.0, Definitions: should be consistent with other tariff definitions of common terms; as in the CGAC, underlying calculations should be described.

> Default Service: definition should be modified to state that the rate charged for default service is the appropriate CGAC rate based on the class to which the customer belongs (HLF or LLF) and the time of the year.

[49] Tariffs should be modified whenever Department authorizes changes to the way rates are determined, changes to any term as defined in the tariffs, or any other authorized change that renders any existing tariffs obsolete, inconsistent or confusing.

Design Day: should be defined consistent with the CGAC definition.[50]

Terms that include the words “peaking” should include in the definitions an explanation of what resources are considered “peaking” and describe the characteristics of peaking resources.

New Section: to describe how specific allocations are made for each category of capacity assigned (pipeline, storage and peaking), including how the underlying allocation factors are developed. This section should explain the whole process of assigning capacity–from the development of allocation factors to the actual assignment of capacity to a supplier, differentiating between daily metered and non-daily metered customers. The proposed new section would bring together the fragments of the process disclosed in other sections into a single section which would greatly enhance the value of this tariff.

The recommendations described above are by no means exhaustive, and address only parts of the Company’s CGAC and T&C tariffs. Other parts of the Company’s tariffs may also suffer from the same or different deficiencies.

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[50] It is curious that the Company does not define or even use the term “Design Day” in its Terms &Conditions–especially given the Company’s reliance on a design day allocator in determining mandatory capacity assignments. Tr. 4, p. 487. This ambiguity and lack of clarity and specificity in tariff language is an example of how it is possible for changes, interpretational or intentional, may slip through without notice, Department review, or approval. Here it appears that the term “design day” is synonymous with “peak day”. Exh. AG-7-29(G), pp. 6-12 (current T&C Definitions).

VII. CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Attorney General submits that the Department should reject the Company's proposed new rates and tariffs, or in the alternative, adopt the Attorney General's pro forma adjustments.

Respectfully submitted,

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